

## **Manufacturer's Exemption**

### **Revenue and Taxation Code Section 6377**

Prepared by the State Board of Equalization  
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**Background.** The partial sales and use tax exemption for manufacturers' purchases of equipment was added in 1993 at the same time that the manufacturers' investment credit was added under the Income and Bank and Corporations Tax Law. The partial sales and use tax exemption became effective January 1, 1994. The Board of Equalization (BOE) adopted Regulation 1525.2, *Manufacturing Equipment*, and Regulation 1525.3, *Manufacturing Equipment – Leases of Tangible Personal Property*, to interpret and make specific the provisions of this partial exemption.

#### **Limited Exemption – New Businesses Only, and Only State Tax Portion.**

The exemption is limited to the *state* tax portion of the total sales and use tax rate, which is currently 5%. In addition, the partial sales and use tax exemption is only available to *new* manufacturers to California. A “new” manufacturer is defined in the law as essentially one that first commenced trade or business activities in a new trade or business in California on or after January 1, 1994, and who has conducted these activities for a period less than three years. Therefore, essentially, once a person has conducted manufacturing activities for three or more years, that person is no longer considered to be a “new” manufacturer and thus, not qualified for the partial exemption thereafter on his or her purchases of otherwise qualifying equipment (on leased equipment, the exemption applies to the lease payments for six years from the start of the lease).

**What *IS* Exempt?** The partial exemption is only available to those persons engaged in the activities described in the 1987 Standard Industrial Classification Manual for manufacturers (Codes 2011 to 3999). The type of purchases that are included within the partial exemption include:

- Any item that is to be used primarily in any stage of the manufacturing, processing, refining, fabricating, or recycling of property, and in research and development activities;

- Special purpose buildings and foundations used as part of these activities, including storage; and
- Any item used to maintain, repair, measure, or test any of that property.

**What's *NOT* Exempt?** The exemption *does not* include:

- Items used primarily in administration, general management, or marketing;
- Items purchased to become incorporated into real property, other than special purpose buildings and foundations; or
- Consumable items with a normal useful life of one year.

**How To Get The Exemption.** To make purchases without the 5% state sales and use tax, a new manufacturer must be both pre-qualified by the BOE and either be registered to hold a seller's permit or maintain a consumer use tax account. When the BOE determines that a person is qualified for the partial exemption, the Board issues an exemption certificate. The certificate contains a control number and the three-year expiration date. The qualified person presents the exemption certificate to those suppliers from whom he or she purchases equipment that qualifies for the partial exemption.

**What Are The Seller's Obligations?** The supplier must obtain and retain a copy of the exemption certificate in order to be relieved of the liability for the tax at the time of sale, but not later than 60 days after the sale. However, the supplier is still liable for the remaining applicable tax (the base rate in California is 7.25%, and depending on the place of sale, the sales tax rate can be as high as 8.5%). An exemption certificate is not considered valid if it has *not* been issued by BOE, or if it is accepted by the seller after the expiration date on the certificate. Qualified persons who have been pre-qualified may reproduce the issued certificates as needed for their qualifying purchases.

The BOE presumes that a seller accepts a manufacturer's exemption certificate from a pre-qualified purchaser in good faith in the absence of evidence to the contrary.

The supplier then files a sales and use tax return – generally on a quarterly basis - claiming the partial exemption and, together with that return, provides BOE

with a copy of the manufacturer's exemption certificate(s). However, suppliers claiming the partial exemption are not required to furnish BOE with copies of manufacturer's exemption certificates for sales at any single physical location to a single qualified purchaser that do not exceed an aggregate total of \$25,000 during a single calendar quarter. Regardless of the total quarterly sales per purchaser, however, BOE may, on 30 days' written notice, require a supplier to begin furnishing the Board with copies of all certificates on a quarterly basis.

Suppliers are required to retain each manufacturer's exemption certificate received from a qualified person for a period of four years from the date on which the supplier claims a partial exemption based on the exemption certificate.

If BOE determines that it is in its best interest, within 45 days of the Board's request, suppliers must furnish to BOE any manufacturer's exemption certificates received from qualified persons, including exemption certificates for aggregate sales or leases of \$25,000 or less to a single qualified person made at any single physical location of the supplier during a single calendar quarter.

**Other Limitations Of The Exemption.** The exemption does not apply if within one year from either the date the item was purchased or first placed into service is either removed from California or converted from an exempt use to non-qualifying use.

The law has a sunset date which provides that the partial exemption will be repealed on January 1 if the total manufacturing sector employment in California as determined by the Employment Development Department on the preceding January 1, does not exceed by 100,000 jobs the total manufacturing employment (excluding the aerospace sector) in California since the beginning date of the exemption (January 1, 1994).